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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

Federal-State Joint Board on Universal Service	)	CC Docket No. 96-45 / FCC 00J-1

AT&T COMMENTS ON JOINT BOARD RECOMMENDED DECISION ON PHASING DOWN INTERIM HOLD-HARMLESS SUPPORT

Pursuant to the Commission's Public Notice, DA 00-1536, released July 11, 2000, AT&T Corp. ("AT&T") submits these comments on the Joint Board's Recommended Decision, FCC 00J-1, released June 30, 2000 ("*Recommended Decision*"), concerning schedules and procedures for phasing out or eliminating the interim hold-harmless provision of the Commission's new forward-looking high-cost support mechanism for non-rural carriers.

In the *Methodology Order*[1] (¶¶ 78-88), the Commission established an interim hold-harmless provision under which non-rural carriers would receive the greater of either their pre-existing universal service support amount or the support to which they would be entitled under the new forward-looking cost-based mechanism. The Commission emphasized that the interim hold-harmless provision is a *transitional*

1 Federal-State Joint Board on Universal Service Reform, CC Docket No. 96-45, Ninth Report & Order and Eighteenth Order on Reconsideration, FCC 99-306, released November 2, 1999 ("*Methodology Order*").

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measure that is intended to protect consumers in high-cost areas from potential rate shock during the shift to the forward-looking mechanism. Accordingly, the Commission asked the Joint Board to provide a recommendation on or before July 1, 2000 concerning how the interim hold-harmless provision can be phased out or eliminated without causing undue disruption to consumer rates in high-cost areas. *Id.* ¶ 88.

Although AT&T generally supports the Joint Board's *Recommended Decision* as how best to phase-down interim hold-harmless support, it strongly disagrees with the recommendation (at ¶ 21) that interim hold-harmless support for exchanges transferred to rural carriers should *not* be phased down following the transfer until the Commission reexamines the operation of Section 54.305 of its rules or reforms the high-cost mechanism for rural carriers, so that replacement support for the transferred exchanges is available. Not only is this recommendation outside the scope of the referral to the Joint Board, it is also totally at odds with the purpose of the rule. Accordingly, the Commission should decline to amend Section 54.305.

As the Accounting Policy Division recently reiterated, "Section 54.305 of the Commission's rules provides that a carrier acquiring exchanges from an unaffiliated carrier shall receive the same per-line levels of high-cost universal service support for which the acquired exchanges were eligible prior to their transfer. For example, if a rural carrier purchases an exchange from a non-rural carrier that receives support based on the Commission's new universal service support mechanism for non-rural carriers, the loops of the acquired exchange shall receive the same per-line support as calculated under the new non-rural mechanism, regardless of the support the rural carrier purchasing the exchange may receive for any other exchanges. Section 54.305 is meant to discourage carriers from transferring exchanges merely to increase their share of high-cost universal service support, especially during the Commission's transition to universal service support mechanisms that provide support to carriers based on the forward-looking economic cost of operating a given exchange."[2]

A non-rural exchange receiving interim hold-harmless support is either entitled to no support based on forward-looking economic cost ("FLEC") or a lower amount of FLEC-based support than the hold-harmless amount. Given this fact, there is absolutely no reason why, if such an exchange is sold to a rural carrier, that the rural carrier should continue to receive the higher hold-harmless amount for an indefinite period.

The Joint Board posits only two rationales for its suggested modification of Section 54.305. First, it suggests that the current rule, "by freezing support based on the seller's embedded costs, . . . prevents the acquiring carrier from receiving an amount of support related to the costs of providing supported services in the transferred

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[2] Citizens Telecommunications Company of North Dakota and U S WEST Communications, Inc. Joint Petition for Waiver of the Definition of "Study Area" Contained in the Part 36 Appendix-Glossary of the Commission's Rules, CC Docket No. 96-45, Memorandum Opinion and Order, DA 00-1548, ¶ 3, released July 12, 2000 (citations omitted). The Commission first adopted FLEC as the basis for determining universal service support in Federal-State Joint Board on Universal Service Reform, CC Docket No. 95-45, Report and Order, FCC 97-157, ¶¶ 199-201, 206, 224-226, released May 8, 1997 ("*Universal Service Order*"), which has already been the subject of review by the Fifth Circuit. That Court expressly upheld the use of FLEC as the basis for determining the need for high-cost support. Texas Office of Public Utility Counsel v. FCC, 183 F.3d 393, 411-12 (5th Cir.1999), *cert. granted sub nom GTE Service Corporation v. FCC*, 120 S. Ct. 2214 (June 5, 2000); *see also* Alenco Communications Inc. v. FCC, 201 F.3d 608, 622 (5th Cir. 2000).

exchange." Second, it asserts that "the rule requires the acquiring carrier to keep separate books of account for the acquired exchanges for an indefinite period of time." *Recommended Decision,* ¶ 20.

Contrary to the Joint Board's first assertion, Section 54.305 does *not* prevent the acquiring carrier form receiving support related to the costs of providing the supported service. Rather, the rule requires, and properly so, that with the phase-down of the interim hold-harmless amount, the carrier providing service to the exchange will receive no more than the necessary FLEC-based support amount. In the *Methodology Order* (¶ 34), the Commission reaffirmed that federal universal service support should be based on forward-looking economic costs, as opposed to the incumbent's embedded costs of providing supported services, because, as it had previously explained, measuring the need for support based on forward-looking cost is necessary "to send the correct signals for investment, competitive entry, and innovation."[3] As the Commission explained, "forward-looking costs will provide sufficient support without giving carriers an incentive to inflate their costs or to refrain from efficient cost-cutting."[4] This remains true whether the exchange is operated by a non-rural carrier or transferred to a rural carrier.

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3 Federal-State Joint Board on Universal Service Reform, CC Docket No. 96-45, Seventh Report & Order and Thirteenth Order on Reconsideration, 14 FCC Rcd 8078, ¶ 50 (1999) (*"Seventh Report & Order"*).

4 *Methodology Order*, ¶ 19.

As to the Joint Board's second justification, even if the acquiring rural carrier needed to maintain a separate set of books for the transferred exchanges in order to comply with Section 54.305 that would not be an extraordinary burden but rather a cost that should be factored in at the time of purchase. More likely, however, the rural carrier would only need to identify separately those exchanges acquired from non-rural carriers which would be subject to the Commission's FLEC-based mechanism, so as to ensure that those exchanges do not enter into the computations for support received under the high-cost mechanisms applicable to the rural carrier's other lines. In granting a recent study area waiver, the Commission's Accounting Policy Division simply directed the acquiring rural LEC "to submit, as part of its annual USF data submission to the fund administrator, a schedule showing its methodology for excluding the costs associated with the 94 acquired access lines from the costs associated with its pre-acquisition study area."[5]

More fundamentally, adoption of the Joint Board's suggestion would undermine the Commission's sound reasons for adopting Section 54.305 in the first instance. The Commission expressly adopted Rule 54.305 to avoid skewing carriers' decisions regarding the purchase of exchanges. As the Commission stated in the *Universal Service Order* (¶ 308), "[u]ntil support for all carriers is based on a forward-looking economic cost methodology, . . potential universal service support payments may

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[5] Rye Telephone Company, Inc. and U S WEST Communications, Inc. Joint Petition for Waiver of Definition of "Study Area" Contained in the Part 36 Appendix-Glossary of the Commission's Rules, CC Docket No. 96-45, Memorandum Opinion and Order, DA 00-1585, ¶ 8, released July 18, 2000.

influence unduly a carrier's decision to purchase exchanges from other carriers. In order to discourage carriers from placing unreasonable reliance upon universal service support in deciding whether to purchase exchanges from other carriers, we conclude that a carrier making a binding commitment on or after May 7, 1997 to purchase a high cost exchange should receive the same level of support per line as the seller received prior to the sale." *Id.*

By contrast, "[a]fter support for all carriers is based on the forward-looking economic cost methodology, carriers shall receive support for all exchanges, including exchanges acquired from other carriers, based on the forward-looking economic cost methodology." Once that occurs, "the level of support will not be a primary factor in a carrier's decision to purchase exchanges because the carrier's support will not be based on the size of the study area nor embedded costs." *Universal Service Order,* ¶ 308. The Joint Board has advanced no valid basis for reversing these findings.

Indeed, if for any reason the Commission decides not to adopt a FLEC-based support mechanism for rural carriers, retaining current Section 54.305 would become even more imperative because of the incentive that the dichotomy in the basis of high-cost support between rural and non-rural carriers would create to transfer non-rural carriers' high-cost exchanges to rural carriers. Moreover, if the phase-down of hold-harmless support were frozen at the time the exchange is transferred to the rural carrier, it would serve only to increase the sales price, *i.e.*, create windfall profits for the non-rural carrier, rather than serving any legitimate universal service support objective.

CONCLUSION

For the reasons stated above, the Commission should *not* adopt the Joint Board's recommendation that exchanges transferred from non-rural to rural carriers should not be subject to the phase-down of the seller's interim hold-harmless support.

Respectfully submitted,

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August 14, 2000

CERTIFICATE OF SERVICE

I, Kelly Hannigan, do hereby certify that on this 14th day of August, 2000, a copy of the foregoing "AT&T Comments on Joint Board Recommended Decision on Phasing Down Interim Hold-Harmless Support" was served by U.S. first class mail, postage prepaid, on the parties named on the attached Service List.

/s/ Kelly Hannigan
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